

# BUDGET BASICS #3

## Recommendations for Budget Reform

### *LABI's 2015 Budget Research Series*



*The third and final installment of a LABI research series to help employers and the public understand the Louisiana state budget, the reasons for the deficit, and potential solutions for government to prioritize spending and promote economic growth and individual prosperity.*

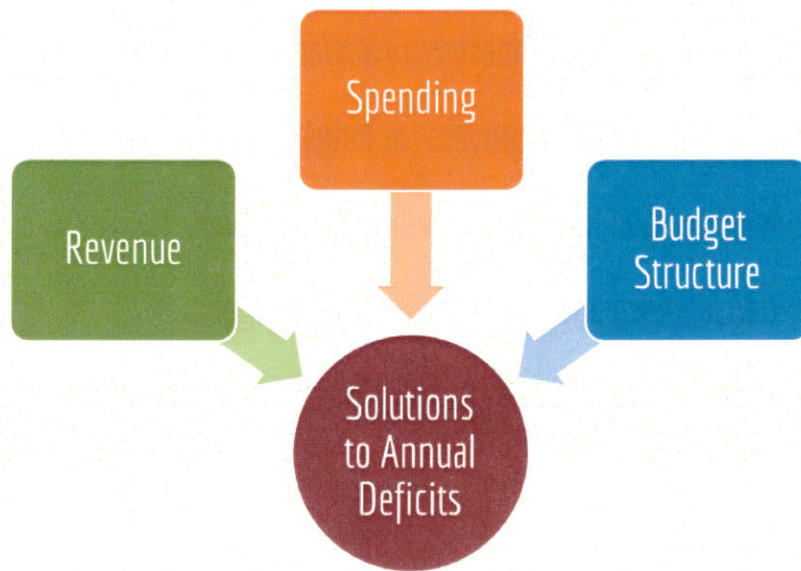
In **Budget Basics #1**, LABI examined three major factors contributing to Louisiana's state deficit:

- Revenue
- Spending
- The structure of the state budget itself with various forms of locked-up funding that make the prioritization of services virtually impossible

**Budget Basics #2** focused on this third factor, taking a closer look at locked-up spending. "Non-discretionary" spending, "self-generated" revenue, and dedications of state revenue are three areas of the state budget that are rarely scrutinized, but consistently funded, and leave fewer dollars for priorities like higher education.

**Budget Basics #3** makes research-based recommendations to address the three factors contributing to Louisiana's state deficit with an emphasis on the structure of the budget itself.

## A Comprehensive Approach is Required



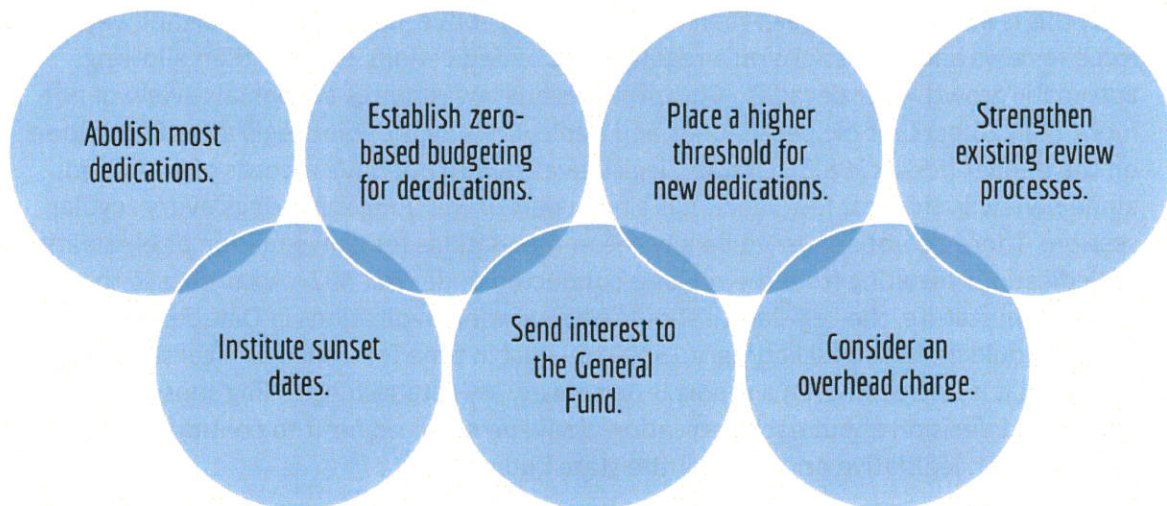
Long-term solutions to perennial state deficits must be comprehensive. **If revenue, spending, and the budget structure are combining to cause the problem, all three must be addressed to solve the problem as well.**

Raising revenue is often discussed as a silver bullet. However, if cost containment is not part of the equation, lawmakers will be pressed to raise revenue year after year to fund the ever-growing needs of state and local government. Perhaps even more importantly, as Budget Basics #2 demonstrates, the structure of the budget must be addressed to allow for prioritization of spending. Locked-up funding that is not reviewed or reduced is no longer an option. Every spending program at the state and local level deserves equal attention as the new Legislature and administration seeks to prioritize state funding.

The choices are not easy, but it can be done. How we prioritize will be key and that is the focus of the following recommendations.



## #1: Unlock dedications to prioritize state spending.



The first way LABI recommends action to address Louisiana's perennial fiscal challenge is to **unlock budget dedications to better prioritize state spending**. Budget Basics #2 is entirely focused on funding that is neither scrutinized nor reduced. Dedicated funds represent billions of dollars of state resources currently on auto-pilot, even as other areas of the budget suffer disproportionately.

According to experts at the National Association of State Budget Officers, it is rare for state budgets to be as heavily dedicated as Louisiana, although cases do exist, such as Oklahoma for example. The following recommendations are somewhat unique to Louisiana's context:

- **Abolish the majority of state dedications.** To start, LABI recommends the Louisiana Legislature eliminate all dedications that are not enshrined in the Constitution and do not fulfill a fiduciary requirement. To help address the significant deficits of the late 1980s, the Roemer administration and the Legislature abolished more than 100 statutory dedications in one bill, unlocking hundreds of millions of dollars for general use. The number of special funds dropped from 197 to 78, freeing up an estimated \$589 million (the total budget was \$6.9 billion). Self-generated revenue also increased – about half due to the elimination of dedications that simply converted to more flexible self-generated revenue. **Act 5 of 1988 directed the Treasurer to abolish funds and deposit the balances into the State General Fund on July 1 of the new fiscal year.** The interest on the investments was also required to be deposited in the General Fund. This law is actually still on the books in RS 49:308.3.

Since then, dedications have been created year after year, slowly locking away billions of dollars in state tax revenue for specific functions of state and local government. Since Fiscal Year 1988, the number of actual funds has grown from 78 to 393. A similar bill in 2016 would allow for scrutiny of state spending through more than 250 funds and more than \$1.5 billion that have largely been left untouched throughout the years of state deficits. Policymakers will need to evaluate whether the agency, operation, or service funded with the dedication is still necessary to the state and will require replacement revenue, if that share of revenue can be reduced, or if the service or function itself should be eliminated (along with the fee in certain instances). The freedom to prioritize hundreds of millions of dollars would be within reach.

- **Consider requiring a small percentage of all dedications flow into the General Fund as overhead, perhaps five percent, but only after more comprehensive and structural reforms have been attempted.** In an April 2015 report, the Public Affairs Research Council recommended this approach, noting that an overhead charge on fee-based dedications in particular “could help pay for related but unfunded costs tied to the administration of the program, such as central accounting services or information technology support.” LABI concurs with this recommendation, although more comprehensive and long-term reforms should be attempted before another stop-gap measure such as this.
- **Strengthen the review processes in current law for statutory dedications and fees for services across state government.** As noted above, current Louisiana law outlines a biennial review process for all special funds and dedications by the Joint Legislative Committee on the Budget, but little action has been taken to comply with the law. LABI recommends RS 49:308.5 be strengthened to require recommendations for consolidation or elimination on each dedication; the deletion of broad exemptions from the reviews; and a public report with findings that are readily available. At a minimum, if funds are included in an annual “fund sweep,” a public review or report detailing the history of balances in the fund and recommendations for changes to the fund should be standard procedure.

Similarly, despite state law that requires it, there appears to be no comprehensive public list of the fees that make up “self-generated” revenue in the Louisiana state budget. Act 1001 of 2010 required the Division of Administration and the Legislature to establish a plan and schedule for the Joint Legislative Committee on the Budget to review and approve all state fees at least once every five years beginning in 2011. The law also requires agencies that charge fees as part of their operating budgets to post the method of fee calculation on the agency website. It is unclear if any such report has ever been produced or if state agencies are in compliance with this transparency provision. LABI recommends the Legislature seek ways to strengthen RS 49:308.6 as well and ensure compliance. **The more transparency the state can provide on locked-up funding, the more opportunity there will be to truly evaluate and fund state priorities.**

organizations to receive capital outlay funding. Only about half of states allow other public authorities outside of state agencies to make capital requests. In 2009, the Legislature limited the General Obligation bond funding of non-state projects to no more than 25 percent of the cash line of credit capacity for projects in a fiscal year, with some exceptions. Going forward, **the Legislature should remove non-public entities from eligibility altogether and reduce the allocation to local government to ten percent.** This action would immediately free up resources for long-postponed statewide infrastructure projects, higher education maintenance, and state roads and bridges.

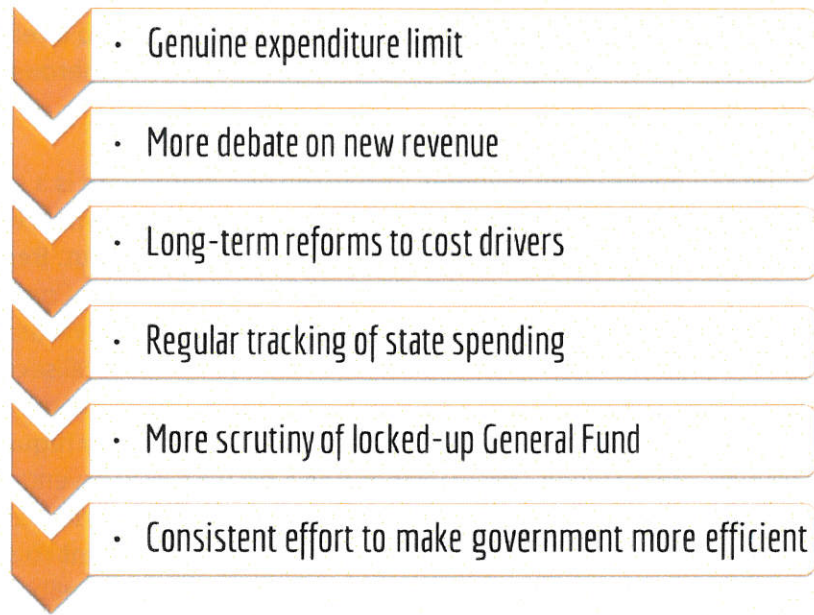
- **Improve revenue forecasting by soliciting the input of the private sector.** Even as mid-year deficits have become a recurring trend, in general, Louisiana's revenue estimating process is sound. Forecasts in Louisiana include information on the next five years, and the Legislature and the executive branch must develop a consensus forecast with third-party input from an economics professor who sits on the Revenue Estimating Conference itself. In addition to these best practices, in some states, public officials directly solicit the input of private sector economists and leaders in an advisory capacity. As noted by the Center for Budget and Policy Priorities: "Executive and legislative fiscal staff are experts on the details of state tax law and on how revenue collections respond to changes in the economy, but predicting the future course of the economy is difficult. **Bringing in outside economists from academia, the private sector, or both, improves the estimates accuracy by adding expertise and more points of view** to the economic forecasts that are the basis of revenue estimates."

In **North Dakota**, a Revenue Advisory Committee of mostly private sector members meets before each forecast is issued to review the economic and tax projections. In **Virginia**, the Joint Advisory Board of Economists, which includes private sector economists along with agency and legislative staff, prepares an economic forecast every fall; this forecast is then deliberated by the Advisory Council on Revenue Estimates, which includes the Governor, legislative chairmen, and members of the business community. In **California**, an estimate of general fund revenue is based on a projection of national economic activity that is actually prepared by an independent company. In **Michigan**, presentations from industry are solicited by the state budget director on current business conditions, investment plans, and outlook prior to the convening of the Revenue Estimating Conference. In line with national experts, LABI recommend the inclusion of private-sector input into economic and revenue deliberations in an effort to improve forecasting.

- **Improve expenditure estimates, which are used to define the budget deficit.** Currently in Louisiana, the official state budget deficit is projected based on revenue forecasts compared to the needs of state government. This figure is grounded in what is known as the "continuation budget" defined in statute as the "funding level for each budget unit which reflects the financial resources necessary to carry on all existing programs and functions of the budget unit at their current level of service in the ensuing fiscal year including any adjustments necessary to account for the increased cost of services or materials due to inflation and estimated increases in workload requirements resulting from demographic or other changes" (RS 39:2). The deficit results from subtracting the expenditures in the continuation budget minus the State General Fund available.



### #3: Limit the growth of government.



As discussed throughout this research series, there are three reasons for the Louisiana state budget deficit and three areas that must be tackled to address it. The first is **budget reform**, and LABI outlined recommendations to this end in the prior two slides. The second is **spending**. While state government has grown 44 percent from Fiscal Year 2005 to Fiscal Year 2016, the state's economy has only grown about 25 percent. Key drivers of this additional spending are outlined in Budget Basics #1.

**To avoid more recurring deficits, it will take more than new revenue and more than budget reform**, although the latter is sure to generate savings as hundreds of millions of dollars is reviewed for the first time in years. State spending and expensive programs must be analyzed and contained where possible, even if the results are years in the making. LABI recommends the following actions be taken to limit the growth in government, save dollars over time, and mitigate future crises:

- **Re-instate a genuine expenditure limit for state government.** Louisiana has a constitutionally mandated expenditure limit, which is defined as not exceeding the expenditure limit for the current fiscal year (actual appropriations from the State General Fund and dedicated funds) plus an amount equal to that limit times a positive growth factor. There are various constitutional exclusions for the appropriations subject to the expenditure limit, including federal funds, self-generated revenues collected by the Board of Regents (i.e. tuition), inter-agency transfers, and severance and royalty payments to local government. The growth factor is constitutionally defined as the average APR change of personal income for Louisiana as defined by the U.S. Department of Commerce for the three calendar years prior to the fiscal year for which the limit is calculated. This definition, however, means that **Louisiana's current expenditure limit is irrelevant** because the budget peaked at such an extraordinarily high level following Hurricane Katrina and just prior to the recession. The limit does not adjust downward without legislative action.

**This year's qualifying expenditures fall \$1.5 billion below the official expenditure limit in Fiscal Year 2016**, which actually increased by 3.65 percent even as the state budget was in a deficit posture. The expenditure limit can be changed in any fiscal year with a two-thirds vote in a specific legislative



in a financial position to do so. These are just a few examples of **data-driven, long-term reform the Legislature can take to help avert future fiscal challenges.**

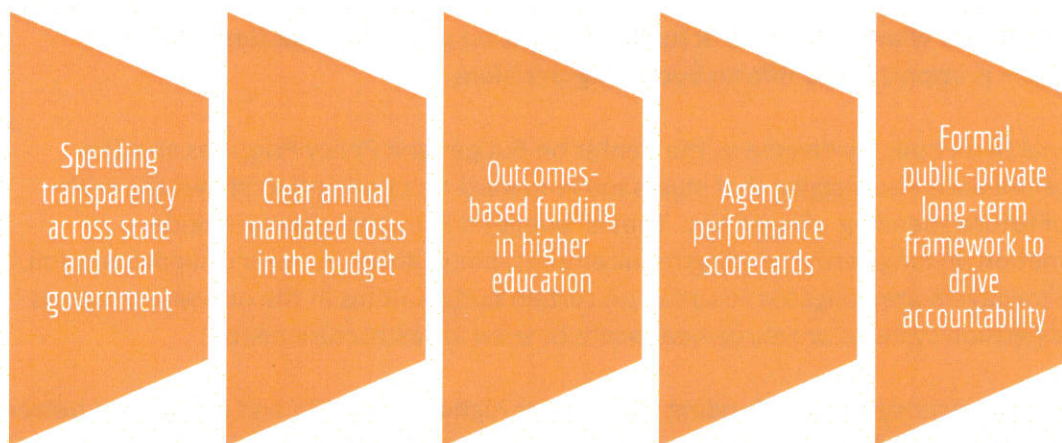
- **Require public interim expenditure monitoring reports for better cost containment and tracking.** Thirty-two states require regular reports on the status of spending throughout the fiscal year. Some are quarterly, some monthly, and some daily. **North Dakota** actually has online, real-time expenditure reporting according to the National Association of State Budget Officers. In Louisiana, budget staff note that interim expenditures are monitored at least quarterly, but are not publicized. This practice stands in stark contrast to revenue tracking, where **Louisiana's Revenue Estimating Conference regularly meets and revises forecasting.** The Center for Budget and Policy Priorities recommends "regular reports that compare the amount spent each month to the amount that the state expected to spend when the budget was adopted. In areas that cost more than expected, the **state can put cost-saving measures in place or reallocate resources within the budget to prevent shortfalls or service reductions.**" Consistent with this best practice, LABI recommends the Legislature require and review spending throughout the year in the same way that revenue is regularly re-assessed and publicly reported.
- **Scrutinize so-called "non-discretionary" State General Fund.** As outlined in detail in Budget Basics #2, more than \$6 billion in "non-discretionary" state spending is required for various reasons for specific functions within most state and local government. However, there is no dedicated funding source for "non-discretionary" spending, so this category of the budget is funded largely with the State General Fund. Many of these mandated expenditures have grown in recent years, such as the Minimum Foundation Program for K12 schools, which has \$900 million more State General Fund today than in Fiscal Year 2005. **Despite the label of "non-discretionary," tens of millions of dollars of growth is also occurring in statutorily required areas that are, in fact, subject to legislative discretion and appropriation,** such as the prison budget, the salaries of District Attorneys, or legislative and judicial expenses – all which have also grown in costs.

This misnomer leads to a rubber stamp for billions of dollars in state spending even as other areas of the budget suffer disproportionately because they are labeled "discretionary" such as higher education. While many "non-discretionary" services would likely still require funding at some level, LABI recommends close examination and potential reductions to generate annual savings. In addition, state and local recipients should be encouraged to explore other Means of Finance and free up State General Fund. Finally, sending constitutional mandates back to the voters for review – in some cases decades after their initial approval – is a legitimate option for the Legislature as well. In short, **"non-discretionary" spending should be subject to rigorous review, debate, and prioritization** against other governmental functions.

- **Do not abandon efforts to make government more efficient.** While some state agencies have seen disproportionate reductions in recent years, that trend does not hold true across state government as dedications, one-time revenue, and short-term solutions have held budgets steady or even increased in certain areas. Lawmakers should seek to implement outstanding recommendations of the Streamlining Commission and the GEMS



## #4: Enact greater transparency and public input in the budget.



Transparency and public input go hand-in-hand with a closer examination of spending and limiting the growth in government. As the Public Affairs Research Council of Louisiana has noted: **“Citizens need maximum access to information if they are to have any chance of influencing decisions or understanding proposed policy and budget changes.”** Based on best practices nationwide, LABI offers the following recommendations for more public engagement in the Louisiana budget process:

- **Expand the state’s budget transparency website beyond executive branch expenditures to include activity in the judicial branch, the legislative branch, and local government.** The state’s LaTrac website has won national recognition, ranking fifth in the nation in the 2015 survey by the U.S. Public Interest Research Group (PIRG). The state scores particular points for including financial and other information for boards and commissions. However, by and large, Louisiana’s online spending databases do not include any information on the other branches of state government, nor of local spending – which is comprised of more than one-third state revenue in Louisiana. **Model states, such as Ohiocheckbook.com which is now ranked #1 in the nation, offer information on all levels of government spending, not just executive branch agencies.** Indiana, for example, maintains a local government transparency website with budget, spending, revenue, and debt information for counties, municipalities, and special districts. In **Alabama**, the public can search down to the cost of postage within the Legislature. States such as **Arkansas, Mississippi, Ohio, and Oregon** among others, include judicial contracts on the state’s transparency website. LABI recommends adding all branches of government as well as local government to state transparency efforts in line with best-practice states. AS U.S. PIRG notes, “It is not possible to ensure that government decisions are fair and efficient unless information is publicly accessible.”
- **Publish the annual mandatory costs to state agencies clearly in the executive budget, appropriations bill, and in official State Budget documents.** In committee testimony, state agency heads, university leaders, local officials, and school districts regularly bemoan the mandatory costs that seem to rise annually consuming greater share of state appropriations. There is little consolidated information on these mandated costs, much less a rationale for the upward trajectory. LABI recommends the state

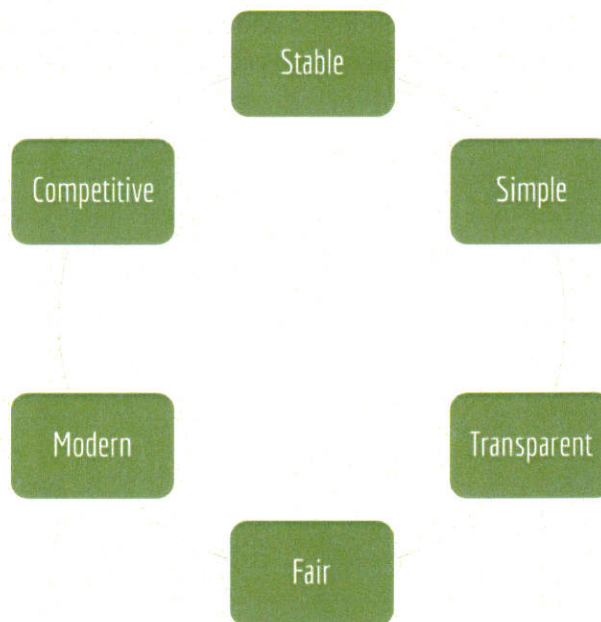


Southern Regional Education Board's 2015 report. At the same time, the workforce needs remain great, and the state does not have an adequately educated population for the jobs of today and tomorrow. The effort to shine a light on performance and drive better outcomes through state financing has never been more important.

LABI recommends that the Legislature and the Board of Regents:

1. **Establish this year's appropriation as a stable baseline** for predictable funding going forward.
  2. **Allocate any and all new resources in an outcomes-based formula** that builds performance models tailored to institutional missions and ends enrollment-driven allocations and "hold-harmless" provisions intended to be temporary that require higher-performing institutions to subsidize institutions with perennial challenges and low performance. The formula should be focused less on "cost" and more on outcomes.
  3. **Grant long-term autonomy in tuition, fees, and operations.**
  4. **Enhance transparency and accountability for the performance of institutions of higher education** including data that shows the available jobs and average salaries upon graduation in major fields. Similar to the new U.S. Department of Education College Scorecard, **Louisiana's leaders should produce institutional scorecards** that are easy to understand for taxpayers and students alike, clearly demonstrating costs for a degree, outcomes, and return on investment. Over time, this information should be utilized in funding decisions.
  5. **With additional funding and more autonomy, policymakers should also consider targeted mechanisms to intervene and turn around chronically low-performing institutions** in an approach similar to the Board of Elementary and Secondary Education with K12 schools.
- **Create agency performance scorecards on a statewide dashboard that tracks progress of the state overall as well as individual program metrics set by each agency.** Louisiana currently collects performance data for most programs and services of state agencies. These indicators are developed by the agencies and reported in the state budget and legislation. However, little is done with this information nor is it easily accessible or comprehensible for the public. States across the country are moving to align budgeting with desired outcomes and performance and 17 states now have dedicated performance websites. **Minnesota**, for example, has a statewide dashboard with 40 key indicators such as personal income per capita or violent crime or voter turnout. Each indicator contains a rationale for why it is a major goal along with five to ten years of data in graph format. In **Vermont**, performance dashboards for state agencies clearly show the goals of each unit (such as reducing the number of people with diabetes for the Public Health Office) and how activities within the department support that goal, with multiple years of measured progress. Finally, **Michigan** produces detailed scorecards for each state agency that include key measures of success, such as business investment for the Economic Development Department, with current values and targets on outcomes such as business start-ups or ROI on travel advertising or business climate perception – all which are updated every couple of months and downloadable as PDFs. LABI recommends the state find ways to better utilize the performance information prepared for the budget so that it

## #5: Adopt a pro-growth tax code.



The focus of LABI's Budget Basics research is state spending and the budget, not the tax structure of Louisiana, which has been well-studied by both public agencies and private organizations over the past year. Nevertheless, **a comprehensive approach to solving the budget deficit will necessarily include policy changes to the tax code**, which is the focus of the fifth LABI recommendation to solve the deficit.

As the Tax Foundation notes: "Taxes matter to businesses, and those places with the most competitive tax systems will reap the benefits of business-friendly tax climates... Every tax law will in some way change a state's competitive position relative to its immediate neighbors, its region, and even globally."

LABI supports a systems of taxation that generates sufficient revenue to deliver an appropriate level of services and functions by state and local government, while adhering to the core belief that private-sector dollars are best utilized to grow the economy and promote prosperity for employers and citizens alike. An effective tax system should promote business investment, generate wealth, increase wages, and expand job opportunities for Louisiana citizens.

Comprehensive tax reform is needed in Louisiana, where **the business tax climate ranked #37 in the recently released 2016 Tax Foundation study**. Louisiana's myriad system of tax exemptions and incentives has been created to mask the poor and uncompetitive foundations of the tax code itself. Systematic overhaul in accordance with key principles is necessary.

LABI advocates for an improved tax system that is:

- **Stable** – Predictability is critical for investment decisions.
- **Simple** – Confusion and complexity in the tax code and in administration lead to higher costs and lost growth potential.
- **Transparent** – The true impact and cost of the tax system must be clearly discernable.
- **Fair** – Citizens and business benefit from governmental services and the tax burden should be shared.
- **Modern** – The tax code should reflect the diversification of Louisiana's economy.
- **Competitive** – States compete for business and economic growth through tax systems, and today's market is mobile and can react to changes in the tax code.





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LABI stands ready and willing to partner with the new Legislature and the new administration in the sizeable task of reforming the state budget. We urge our leaders to take a comprehensive approach incorporating short and long-term solutions and hope the best-practice recommendations outlined above serve as a useful starting point.